AUGUST 1990
A CAHNERS PUBLICATION

Industrial Distribution

THE BUSINESS MAGAZINE FOR INDUSTRIAL DISTRIBUTORS

SPECIAL:

Fluid power outlook

EXCLUSIVE: Distributor/ supplier roundtable

p.18

Full-year buying power has Drago smiling

Joseph Drago
Drago Supply
Port Arthur, TX

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Joe Drago's smiling at the full year's worth of orders that determine his price from Stanley-Proto.

Cover photography by Janice Rubin

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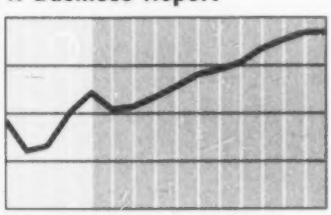

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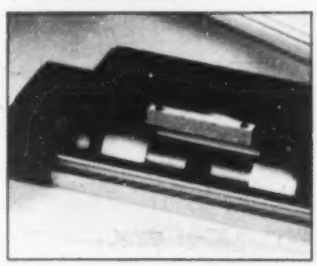

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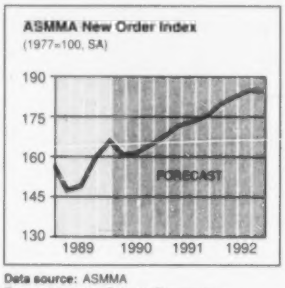
BUSINESS REPORT

BY KRIS BLEDOWSKI

Good News! Inventories are flat

Look for repeat of mid-'80s pattern to start in 3Q.

With regard to the position of inventories, the current slowdown in manufacturing resembles the one of 1986. Beginning in late '85 inventories stopped growing and actually began falling while production slowed. This surprised many experts because business contractions have historically been accompanied by unintended inventory accumulation, especially when a slump begins. The unusual combination in '86 contributed to a severe shortage of goods when the slack proved temporary and demand spurted in mid-'87. In the ensuing expansion, inflation-adjusted total manufacturing output registered a 6.0% gain in '87 and a 5.8% growth in '88.



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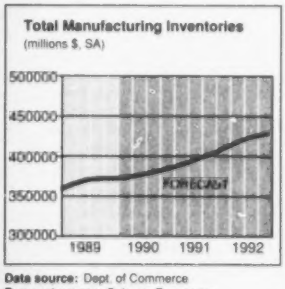
Forecast source: Cahners Economics

Data source: I.D.A.
Forecast source: Cahners Economics

The current situation, while not as dramatic, bodes well for the next two years. Inventories for both total manufacturing and durable goods stopped growing last August and have stayed stable since. Although growth rates are still positive overall, they have begun to contract slightly. Goods produced but not sold will start to rebound in the last quarter of '90 or first quarter of '91, several months after the expansion sets in. That's when you can expect firms to begin stocking up, certain that the upswing is underway.

The ratio of inventories to shipments for total manufacturing grew marginally from about 1.57 in late '88 to about 1.60 by the end of '89, but then fell back to 1.56 again. During the '86 slowdown the ratio did not drift up significantly because the fall in shipments (down 0.8% in current dollars by the end of '86) was accompanied by a steep drop in inventories. The general trend toward lower holding inventories will continue in the future. Expect the inventory-to-shipments ratio to stay in the 1.56 to 1.58 range for the next two years.

The current production lull will change when output picks up during the third quarter of this year. Our upwardly-revised forecast for industrial production (inflation-adjusted) calls for growth of 1.7% this year, and another 5.3% in '91. This expansion will not be as robust as the one we saw in '87 and '88, and it will be a bit shorter. This will bring it in line with the more muted business cycle that we have observed in the past decade. □



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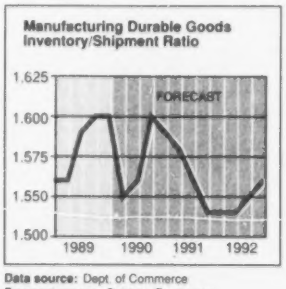

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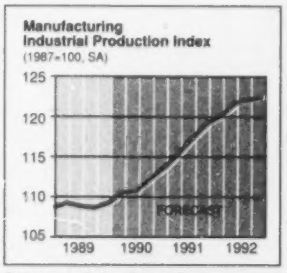


Data source: Federal Reserve Board
Forecast source: Cahners Economics

(1977=100)	SALES May 1990	SALES April 1990	SALES May '90 vs May '89 % change	RECEIVABLES May 1990 days	INVENTORY May 1990 % change
TOTAL	196.1	189.6	+1.6	37.9	-0.5
EAST	175.3	157.3	+8.9	41.8	-0.1
SOUTH	265.8	264.3	+3.0	35.5	-0.1
CENTRAL	185.6	183.9	+4.0	39.4	-1.2
WEST	208.8	202.3	-6.9	33.7	+0.2

SOURCE: Industrial Distribution Assn.

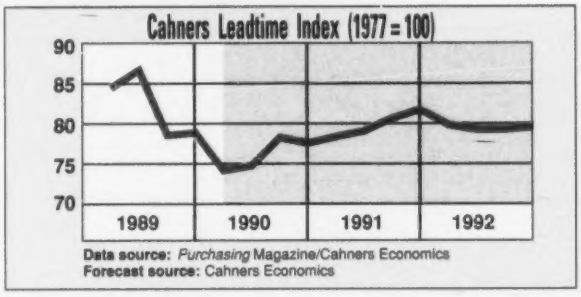
SUPPLY OUTLOOK

BY PAUL WATERS

Economic outlook brightens

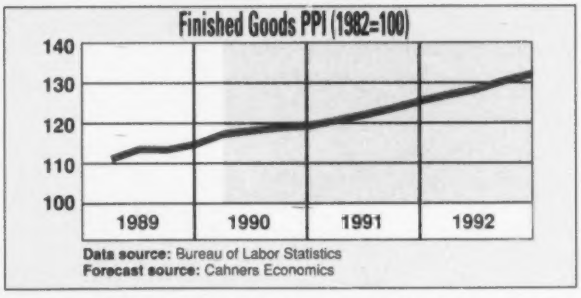
Calm indices point to rebound by year's-end.

One indication of a bright economy is that several producer price indices (PPIs) continue to trend down. Surveys by the National Assn. of Purchasing Managers and *Purchasing* Magazine suggest that buyers no longer face climbing prices on industrial goods. The PPI for finished goods was virtually unchanged for the first half of the year and is estimated to be only 4.2% above year-ago levels. Similarly, inflation on industrial machinery and equipment was only 3.0% for the first six months of 1990. Fabricated metal product prices rose a mere 1.6% during the same period. Expect this good news on inflation to continue, with the PPI for finished goods rising 4.3% in 1990. Excluding food and energy components, look for a jump of only 3.5% this year.

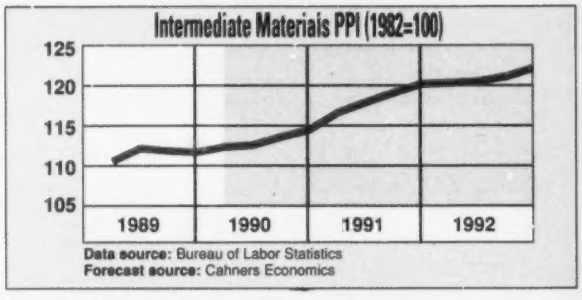


Further evidence of moderating inflation is provided by the PPI for intermediate materials. The less prices on intermediate goods jump, the less need for producers to pass higher costs onto finished goods. The intermediate materials PPI rose just 1.0% from January to June, and is expected to climb only 1.7% for the year. This will be down from a 4.6% surge in 1989. Again excluding food and energy components, expect the PPI for intermediate goods to inch up 1.0% in 1990.

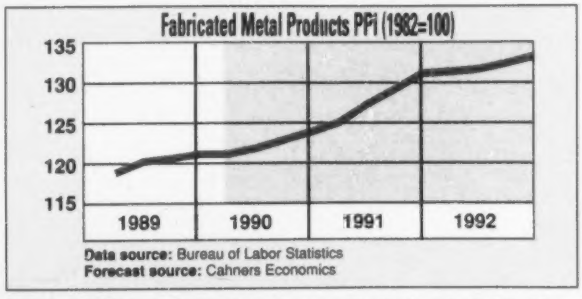
Leadtimes have shrunk during the economic slowdown, further reducing pressure to raise prices. The Cahners Leadtime Index of 125 Industrial Materials continues to be below year-ago levels, indicating that buyers have few problems sourcing most goods. Through June of this year, the index was 13% below 1989's numbers. Renewed economic growth in the second half of the year will stretch leadtimes out, however, so expect the index to drop 7.2% for all of 1990. Delivery times will continue to rise through 1991 as the economy heats up, climbing 5.0% by year's-end.



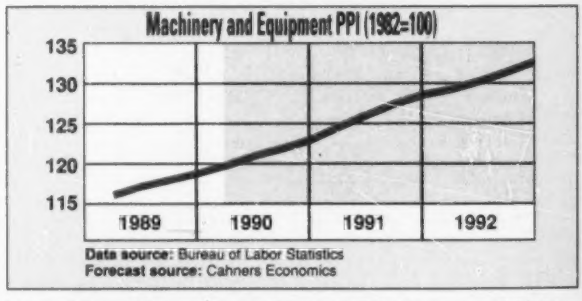
Inflation on finished goods will log in at 4.3% this year and slip to 3.5% in 1991.



Low price hikes on intermediate materials will help tame finished goods inflation. Look for a 1.7% price hike in 1990.



Prices of fabricated metal products will climb only 2.4% this year, after surging 4.9% in 1989.

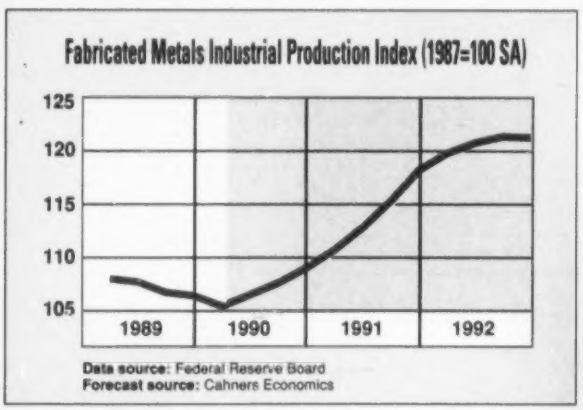


Industrial machinery prices will rise 3.3% this year and higher demand will boost tags 4.3% in 1991.

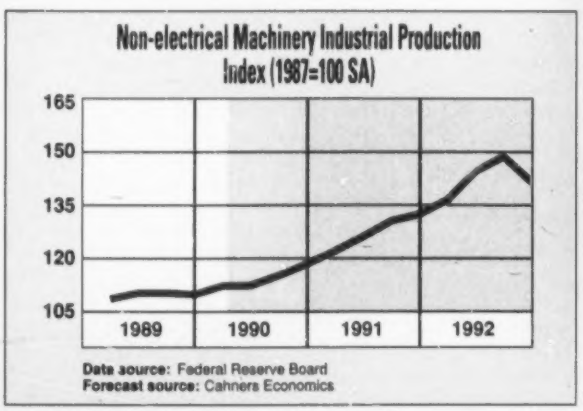
SUPPLY OUTLOOK

OEM industries rebound in 1991

Combined output from the various original equipment manufacturing (OEM) industries will be virtually unchanged in 1990, but should surge 6.8% in 1991. The short-term outlook for the fabricated metals sector typifies the group as a whole. These metals will see production stagnate this year, but will then swell at a healthy rate of 6.7% next year. Production of both hardware and fasteners will also be unchanged this year, as end user firms cut back on inventories of non-essential goods. However, projections for each of these sectors call for encouraging rebounds next year, as improved cash flow entices manufacturers to rebuild stocks which they had depleted this year. On the other hand, and in a somewhat surprising development, the non-electrical machinery sector will buck the prevailing OEM trend by posting a significant 4.0% expansion this year, followed by a truly impressive 10.4% growth in 1991. High levels of capital outlays over this year's short term, and an anticipated improving economy next year will spur these surges. □



The fabricated metals sector is expected to turn in a lackluster performance in 1990, but then post a robust 6.7% gain in sales next year.



Non-electrical machinery sales are showing surprising strength this year, with 4.0% growth anticipated by year's end. Expect an additional 10.4% expansion in 1991.

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